



Valuation + Strategy → Value Enhancement

April 18, 2007

Mr. Lawrence Smith
Director – Technical Application and Implementation Activities
FINANCIAL ACCOUNTING STANDARDS BOARD
401 Merritt 7
Norwalk, Connecticut 06851

Sent Via File Transfer to File Reference No. 1520-100

Dear Mr. Smith:

Thank you for this opportunity to respond to the invitation to comment on "valuation for financial reporting" from the FINANCIAL ACCOUNTING STANDARDS BOARD ("FASB") dated January 15, 2007. I preface my comments with the following:

- I believe that guidance is needed due to the diversity of practice in this domain.
- I believe that such guidance should be issued by the FASB, but should be formulated under the aegis of the APPRAISAL FOUNDATION.
- I believe that, as a practical matter, the current Balkanization of valuation credentials and membership organizations precludes the development of international standards until a workable set of U.S. standards is in place.

Specific comments begin on the next page. I welcome the opportunity to discuss these views further at your convenience at 540.463.6200.

Sincerely,

WARREN D. MILLER
CFA, ASA, CMA, CPA
Principal & Cofounder

Question #1: Is there a need for valuation guidance specifically for financial reporting?

Yes, valuation guidance for financial reporting is needed. This area is becoming more and more important as the FASB requires more and more fair-value accounting and disclosure. Moreover, I believe expect that the issuance of SFAS 157 will multiply the already-considerable implementation issues in valuation for financial reporting. Thus, there is a real-world need.

There are three primary valuation approaches—market, income, and cost (or asset-based). Within each approach are different methods. The nature of the asset or liability being valued and the assumptions the professional makes about the valuation entity tend to guide the choice of methods. In some instances, however, only one method under one approach may be feasible. The already-considerable complexity is exacerbated by recent Tax Court cases that have, in effect, eliminated the long-standing practice of tax-effecting earnings streams in pass-through entities.

Now, if each approach or method is correct, the result is a troubling diversity of practice. To further complicate matters, auditors who review the work of valuation specialists sometimes insist on 'their' methodology; this tends to be audit-firm-specific. Valuation professionals might not be familiar with a given firm's preferred methodology and, worse, might not agree with it. Therefore, valuation practice needs some 'approved' approaches.

Worst of all, few auditors understand valuation frameworks, issues, or methodologies. There are a multitude of reasons for that, but the primary one, in my view, is simple: valuation looks forward, auditors look backward, and ne'er the twain shall meet. The auditor community will not understand valuation until/unless accounting curricula and the CPA exam are thoroughly revamped and broadened to include more courses in finance, economics (especially industrial organization), and strategic management.

<u>1a</u>: Should valuation guidance include conceptual valuation guidance, detailed implementation guidance, or a combination of both?

In a Panglossian world, only conceptual guidance would be necessary. In practice, however, it is hard for outsiders to come to specific accounting conclusions solely on the basis of FASB's Conceptual Framework. Therefore, detailed guidance is probably necessary in perhaps the dozen most challenging valuation areas.

<u>1b</u>: What should be the duration of any valuation-guidancesetting activities?

As business continually changes, and valuation requirements develop, I do not believe that this standardization effort can be or should be a "one-shot" effort. Rather the duration should be ongoing.

<u>Question #2</u>: What level of participation should existing appraisal organizations have in establishing valuation guidance for financial reporting?

The six existing membership organizations—the CFA INSTITUTE, AICPA, NACVA, ASA, IBA, CICBV—should have <u>no role whatsoever</u> in this process. At least three of the organizations (AICPA, IBA, and NACVA) are self-interested and motivated solely by whatever will maximize their own flows of annuity income. For AICPA and NACVA, in particular, that means pandering to the lowest level of professional competence. This field has too much of that already. These two organizations care about the welfare of clients as much as a wolf cares about a toy dachshund. To make matters worse, which requires a stretch of the imagination, four of the six already have their own valuation standards in place. The AICPA has tried since September 2002 to become the fifth issuer and has failed miserably, thank goodness.

Those facts make these organizations different from the APPRAISAL FOUNDATION, which is not a membership organization. It is responsible, however, for formulating and periodically updating the *Uniform Standards of Professional Appraisal Practice (USPAP)*. *USPAP* comprises ten broad standards which govern appraisal practice and appraisal reports in the areas of real estate, machinery and equipment, personal property, business valuation, and appraisal-report reviewing. The APPRAISAL FOUNDATION was created in the late 1980s after the implosion of the U.S. savings-and-loan industry largely, if not solely, as a result of diversity in practice among real estate appraisers and membership organizations. It is funded by its 13 sponsoring organizations (5%), by the sale of publications and services (70%), and by federal grants (25%). It does not allow individuals to be sponsors.

For its part, the APPRAISAL ISSUES TASK FORCE (<u>www.aitf.info</u>) has tried to bring about a reduction in diversity, but it lacks 'official' status. AITF is an *ad hoc* group of about 75 individual appraisers who meet quarterly to discuss vital issues in business valuation; it sometimes issues comment letters. Representatives from the FASB, SEC, and PCAOB have attended most meetings.

The APPRAISAL FOUNDATION has the status that AITF does not have and the independence that credentialing organizations do not have. However, its future success in drafting valuation standards for financial reporting will require (a) broad-based participation and (b) open and transparent processes. The FOUNDATION'S initial effort seems to be limited to a select group of 'insiders.' However, it is too early to judge – perhaps its work will get traction and be widely accepted. I hope so.

I strongly believe that those who would draft valuation guidance for financial reporting must have lengthy and diverse full-time valuation experience. To be sure, auditors, preparers, and users should be part of any task force charged with drafting valuation guidance for financial reporting. But primary responsibility for drafting such guidance must of necessity reside with those who have the experience and understand the issues, which are many, arcane, complex, ambiguous, and difficult.

However, unlike its authority with *USPAP*, we believe that the FOUNDATION should <u>not</u> be the final arbiter over valuation standards. That is because many CPAs are intimately involved in preparing valuations. Therefore, any valuation guidance for financial reporting must compel CPAs to comply; without such compliance, the current diversity of practice will only worsen. The sole entity with the power to get CPAs' attention is FASB. But valuation is far too important an issue to be left to the accountants.

<u>Question #3</u>: What process should be used for issuing valuation guidance for financial reporting?

If the effort now underway at the APPRAISAL FOUNDATION can be opened up and broadened, I believe it offers the right path. But, because of the significant involvement of CPAs in valuation matters, and because corporate officers have final responsibility for financial reporting, I believe the FASB must be the ultimate issuer of valuation guidance. Once it receives a draft from the APPRAISAL FOUNDATION'S task force(s), FASB's due-process approach should be followed. That process involves users, preparers, and auditors.

Question #4: Should the process of valuation guidance be on an international or national level?

I believe it must begin at the national level. With the plethora of membership organizations and conflicting sets of business valuation standards al-

ready in place in North America, developing domestic consensus will be plenty hard. Involving cultures without the traditions of openness and transparency that are the roots of U.S. practice is an invitation to disaster, in my view. While I strongly support the goal of international standards, I also believe that domestic standards must come first, just as FASB's pronouncements preceded the IASB's.

That is why I oppose the restructuring proposal that the IVSC is now considering. I worry that a premature effort to establish international standards will either fail or, even worse, lack credibility and acceptance. That would hurt everyone, but especially users of financial statements.

Other Issues

1. Who should grant authority to issue the valuation guidance?

Congress, through the SEC to the FASB. It appears to me that this authority already exists.

2. What due-process procedures should the standard-setter follow in issuing valuation guidance?

The existing due-process procedures, including Invitations to Comment, Exposure Drafts, and public hearings when necessary, should also work well for valuation issues.

3. How should any organization that issues valuation guidance be funded?

In order to keep the several appraisal membership organizations from co-opting the process, I believe that it is best for funding to come through FASB's revenues from Sarbanes-Oxley. If the APPRAISAL FOUNDATION is, as I hope it will be, actively involved in the development of guidance that FASB subsequently issues, then both organizations should share in the funding; whether the sharing should be equal or not remains to be seen.